NOVA SCOTIA UTILITY AND REVIEW BOARD

AUTOMOBILE INSURANCE REVIEW

REPORT

May 13, 2003

REPORT

NSUARB-INS-02
2003 NSUARB 53

NOVA SCOTIA UTILITY AND REVIEW BOARD

IN THE MATTER OF THE INSURANCE ACT

- and -

IN THE MATTER OF AN EXAMINATION of the **Rates for Private Passenger Automobile Insurance** in Nova Scotia, Pursuant to **s. 157** of the **Insurance Act**

BEFORE:

John A. Morash, C.A., Chair
John L. Harris, Q.C., Member
Kulvinder S. Dhillon, P. Eng., Member

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HEARING DATES:	September 23, 24, 25, 26, 27, and November 26, 27, 28, 2002
FINAL SUBMISSIONS:	January 13, 2003
REBUTTAL:	January 20, 2003
SUPPLEMENTARY SUBMISSIONS:	February 5, 2003
LIST OF WITNESSES:	APPENDIX A
BOARD COUNSEL:	S. Bruce Outhouse, Q.C.
BOARD COUNSEL CONSULTANTS:	**MMC ENTERPRISE RISK CONSULTING LIMITED** Paula L. Elliott, FCAS, FCIA Theodore J. Zubulake, FCAS, MAAA, FCIA
REPORT DATE:	**May 13, 2003**

TABLE OF CONTENTS

1.0 Introduction 1

2.0 Automobile Insurance in Nova Scotia 9

3.0 Development of Insurance Rates 15

4.0 Analysis of Private Automobile Insurance Rates in Nova Scotia 18
- 4.1 MMC's Report - Major Findings 18
- 4.2 Premium Increases and Claim Cost Experience, 1997-2001 20
  - 4.2.1 Board Findings - Premium Increases and Claim Cost Experience, 1997-2001 23
- 4.3 Soft Tissue Injuries 24
- 4.4 Operating Expenses 26
  - 4.4.1 Board Findings - Operating Expenses 27
- 4.5 Reserves 27
  - 4.5.1 Board Findings - Reserves 29
- 4.6 Investment Income 29
  - 4.6.1 Board Findings - Investment Income 31
- 4.7 Industry Profitability 32
  - 4.7.1 Board Findings - Industry Profitability 35
- 4.8 Rate of Return on Equity (ROE) 35
  - 4.8.1 Board Findings - Rate of Return on Equity 39
- 4.9 Premium Adequacy and Future Claim Costs 40
  - 4.9.1 Board Findings - Premium Adequacy and Future Claim Costs 41
- 4.10 Restrictive Underwriting Practices 41
  - 4.10.1 Board Findings - Restrictive Underwriting Practices 44

5.0 Rate Shock and Future Actions 44

6.0 Possible Changes in Rate Regulation System in Nova Scotia 46

7.0 Board Conclusions 50

APPENDIX A 54

1.0 Introduction

[1] By letter dated February 7, 2002, the Honourable David Morse, then Minister of Environment and Labour, pursuant to **Section 157(1)** of the **Insurance Act** , R.S.N.S. 1989, c. 231, requested the Board to "examine the rates for private passenger automobile insurance in Nova Scotia". **Section 157** reads as follows:

> **157(1)** The Board may of its own motion and shall, when so requested by the Minister of Housing and Consumer Affairs [now Environment and Labour], examine into and concerning the rates for all or any class or classes of automobile insurance in or in any part of the Province.
>
> **(2)** It shall be the duty of the Board after due notice in the Royal Gazette and a daily newspaper published in the City of Halifax and after a hearing to order an adjustment of the rates for automobile insurance whenever it finds such rates to be excessive, inadequate, unfairly discriminatory or otherwise unreasonable.

The Board is pleased to submit this Report in response to the Minister's request.

[2] By Order dated June 28, 2002, the Board issued directions on procedure and directed that a hearing be held to receive evidence and comments from interested members of the public. The hearing was advertised in the six daily provincial newspapers and the Yarmouth Vanguard. The hearing extended over eight days between September 23, 2002 and November 28, 2002, and included an evening session on September 26, 2002. Eleven formal participants appeared at the hearing.

[3] The principal insurance industry participant at the hearing, and the only participant to file a formal actuarial report, was the Insurance Bureau of Canada (IBC). IBC is the national trade association of the private sector property and casualty insurance companies in Canada. Representatives of three insurance companies gave evidence. Rex Guy of the Nova Scotia Senior Citizens' Secretariat made a presentation and Gordon Adair, CA, gave evidence on behalf of the Nova Scotia Coalition Against No Fault

Insurance, the Nova Scotia Provincial Injured Workers Association, and the Nova Scotia Designer Crafts Council . The other participants did not call evidence. However, many of them were represented by counsel and they actively cross-examined the witnesses who appeared on behalf of the industry, as well as Board Counsel's witnesses.

[4] The Board received numerous letters of comment and twelve members of the public presented their views at the hearing.

[5] The Board retained MMC Enterprise Risk Consulting Limited (MMC) to provide actuarial consulting services to the Board to assist it in determining whether or not private passenger automobile insurance premiums in Nova Scotia are "excessive, inadequate, unfairly discriminatory or otherwise unreasonable." In recent years, MMC has provided actuarial advice to the Alberta Automobile Insurance Board, the Financial Services Commission of Ontario and the Newfoundland and Labrador Public Utilities Board. Specifically, the Board asked MMC to do the following:

(i) Conduct an actuarial review of insurance industry loss experience to develop a baseline premium level for the Board upon which individual insurer premium levels could be compared.

(ii) Review the historical loss trend and loss development experience, and assess whether the average premium level increases were reflective of the underlying experience in Nova Scotia, and what to expect in the future.

(iii) Assess the use of investment income in the determination of the automobile insurance premiums.

(iv) Review and analyse the individual premium levels, and underwriting and rating manuals, of insurers providing private passenger automobile insurance in Nova Scotia for any evidence of discriminatory rating or eligibility practices.

(v) Develop profiles of typical drivers, compare the premiums charged by individual insurance companies against the baseline premium level for these profiles, and identify any possible excessive premium levels of individual insurers.

(vi) Provide the Board with any finding of excessive, unreasonable, or discriminatory premiums charged by insurers, and the actuarial support for alternative (i.e., more appropriate) premiums in those cases where unwarranted premiums are identified.

[6] MMC based its analysis on information collected by IBC on behalf of the provincial Superintendents of Insurance pursuant to the provincial statistical plans, commonly known as "Green Book" data; financial information contained in individual insurance company "P&C" reports to the federal Office of the Superintendent of Financial Institutions (OSFI) and the provincial Superintendents; and information obtained by MMC from a survey it conducted of 28 insurance companies doing business in Nova Scotia. The 28 companies represent 12 insurance groups and account for approximately 86% of the private passenger automobile insurance market in Nova Scotia. With the exception of a company which is no longer writing automobile insurance in Nova Scotia, the companies surveyed are listed in Table I on page 4.

TABLE I

Companies surveyed by MMC

All figures are for 2001 Premiums in ($000's)	Written Prem.	Market share
Total Industry	**330,441**	
ING Group	**59,094**	**17.9%**
-ING Ins. Co of Canada (+Zurich)	*58,599*	*17.7%*
-ING Novex Ins. Co of Canada	*495*	*0.1%*
CGU Group	**47,801**	**14.5%**
-CGU Ins. Co of Canada	*35,927*	*10.9%*
-Traders Gnl Ins. Co	*4,479*	*1.4%*
-Elite Ins. Co	*3,896*	*1.2%*
-Scottish and York Ins. Co Ltd	*3,499*	*1.1%*
Economical Insurance Group	**44,457**	**13.5%**
-Economical Mutual Ins. Co	*30,121*	*9.1%*
-Perth Ins. Co	*6,349*	*1.9%*
-Federation Ins. Co of Canada	*5,562*	*1.7%*
-Waterloo Ins. Co	*2,425*	*0.7%*
Royal & SunAlliance Can. (Group)	**32,879**	**10.0%**
-Royal & SunAlliance Canada	*18,797*	*5.7%*
-Unifund Assurance Co	*14,082*	*4.3%*
Co-operators group	**22,160**	**6.7%**
-Co-operators Gnl Ins. Co	*16,891*	*5.1%*
-Sovereign Gnl Ins. Co	*3,972*	*1.2%*
-COSECO Ins. Co	*1,298*	*0.4%*
Meloche Monnex Inc. (Group)	**15,153**	**4.6%**
-La Sécurité Nationale, cie d'ass.	*11,278*	*3.4%*
-Primmum Ins. Co	*3,875*	*1.2%*
Dominion of Canada Gnl Ins. Co	**14,702**	**4.4%**
Allstate	**17,549**	**5.3%**
-Allstate Ins. Co of Canada	*7,208*	*2.2%*
-Pembridge Ins. Co	*10,341*	*3.1%*
Wawanesa Mutual Ins. Co	**12,817**	**3.9%**
Citadel Gnl Assurance Co	**8,111**	**2.5%**
Fairfax Financial	**5,697**	**1.7%**
-Lombard Ins. Co Ltd.	*2,492*	*0.8%*
-Lombard Gnl Ins. Co of Canada	*1,961*	*0.6%*
-Zenith Ins. Co	*1,244*	*0.4%*
Allianz Canada	**3,385**	**1.0%**
-Trafalgar Ins. Co of Canada	*2,683*	*0.8%*
-Allianz Ins. Co of Canada	*702*	*0.2%*
Companies selected	**283,806**	**85.9%**

(MMC Report, Exhibit A-31,Section 1, p. 21)

[7] Information requests (IRs) to formal participants and to MMC were issued on September 6, 2002. Responses to the IRs were received by all parties on September 18, 2002. The hearing commenced on September 23, 2002, adjourned on September 27, 2002, reconvened on November 26, 2002 and concluded on November 28, 2002. The Board received closing submissions from the participants by January 14, 2003 and rebuttal submissions on January 20, 2003. Information initially provided to MMC on a confidential basis, but for which confidentiality was subsequently waived, including projected and achieved rate of returns for individual insurance companies, was filed by MMC on January 23, 2003 and was subsequently distributed to all formal participants on January 27, 2003. In light of this additional information, the Board extended the date for filing supplemental submissions to February 5, 2003.

[8] The Canadian Bar Association - Nova Scotia Branch (CBA), as part of its Rebuttal Brief, which was dated February 3, 2003, and received by the Board on February 5, 2003, enclosed a study, entitled "Nova Scotia "Whiplash" Case Review: Trends in Non-Pecuniary Damage Awards over the Past Twenty Years." The study was funded by the CBA and was prepared by the CBA's Special Committee on Insurance Reform in consultation with Tessma Astatkie, Ph.D.

[9] Peter Gurnham, Q.C., Counsel for IBC, in a letter dated February 5, 2003, commented on the late introduction of this study, as follows:

> The report is dated July 26, 2002, and therefore was available to be included as part of the evidence in this hearing. Neither IBC nor any other party has had an opportunity to review the report, or test its conclusions through the interrogatory process or in cross-examination.
>
> The Board's Rules for this hearing set up a protocol to ensure procedural fairness whereby evidence was available in advance, parties were given an opportunity to pose information

requests and the authors of that evidence were made available for cross-examination.

None of that has taken place in connection with Dr. Astatkie's report.

Mr. Brooker in his letter says that CBA made a determination not to file the report at the hearing given the Board's limited mandate. Having made that determination CBA cannot now put it into evidence a week after final submissions in breach of the procedural rules set by the Board.

[10] The Board has reviewed this matter, and agrees with the views expressed by Mr. Gurnham. The Board considers that it would be inappropriate to rely on this study without any of the participants having had an opportunity to cross-examine the authors. Accordingly, in the preparation of this report, the Board has not relied on any information contained in the CBA study.

[11] Nova Scotia has a "file and use" rate regulatory system which only requires companies writing automobile insurance in the regular or voluntary market in Nova Scotia to file their rates with the Board ten days in advance of their going into effect. They become effective automatically at the expiration of the ten days.

[12] The Board is required, however, to approve automobile insurance rates proposed by the Facility Association. Facility Association is an unincorporated, non-profit association of insurers formed in 1977. It commenced operations in Nova Scotia in 1981. All licensed insurers writing automobile insurance in Nova Scotia are required to be members of Facility Association. The law requires all motor vehicles operating in Nova Scotia to be insured, and Facility Association's mandate is to ensure the availability of automobile insurance coverage to owners and operators of motor vehicles who otherwise would have difficulty obtaining same. It provides what is often referred to as a residual

market or "market of last resort". Facility Association is not an insurance company. It operates through servicing carriers who collect premiums, issue policies and service claims on behalf of its members.

[13] Pursuant to **s. 5** of the **Insurance Act,** the Superintendent of Insurance "has general supervision over the business of insurance in the Province". The Office of the Superintendent licenses all insurers, brokers and agents, and adjusters operating in the Province and has the authority to take disciplinary action if the **Act** is not followed. It responds to complaints and enquiries and provides information about insurance matters but does not become involved in the settlement of insurance claims.

[14] The web site of the Financial Institutions Division, under which the Office of the Superintendent falls, indicates that the Division "responds to approximately 400 documented complaints and about 5,000 enquiries annually which are predominantly insurance related". The web site also indicates that the Division "administers the collection and verification of $34 million in insurance premiums tax annually and administers the collection of a levy on all auto insurers of about $10 million for the Department of Health".

[15] IBC has a second role, quite separate from its role as a trade association. It is the statistical agent for Nova Scotia for automobile insurance statistical reporting purposes pursuant to **s. 156** of the **Insurance Act**. IBC performs the same function through its Insurance Information Division for the other three Atlantic Provinces, Ontario, Alberta and the three territories. **Section 156** reads as follows:

> **156(1)** Every licensed insurer which carries on in the Province the business of automobile insurance shall prepare and file with such statistical agency as may be designated by the Governor in Council a record of its automobile insurance premiums and of its loss and

> expense costs in the Province in such form and manner, and according to such system of classification, as the Superintendent may approve.
>
> **(2)** The Superintendent may require any agency so designated to compile the data so filed in such form as he may approve, and the expense of making such compilation shall be apportioned among the insurers whose data is compiled by such agency by the Superintendent who shall certify in writing the amount due from each insurer and the same shall be payable by the insurer to such agency forthwith.

[16] The Insurance Information Division of IBC collects and compiles automobile insurance data and publishes insurance statistics in accordance with the Automobile Statistical Plan approved by each of the above jurisdictions' Superintendent of Insurance or similar regulatory authority. The Statistical Plan sets out the reporting format, lines of business, rating variables, coverages and territories to be used in conjunction with loss and premium data which must be submitted to the statistical agent by the insurance companies. All insurance companies licensed to write automobile insurance in Nova Scotia must comply with these reporting requirements whether or not they are a member of IBC. The automobile insurance experience statistics are published by IBC in a series of "Automobile Insurance Experience (AIX)" exhibits which collectively, as indicated above, are sometimes referred to as the "Green Book".

[17] At the hearing, several of the non-industry participants challenged the accuracy of the statistical data published in the Green Book. This issue will be discussed in Section 3 of this report.

[18] There are four statistical rating territories in the Province: 501 - Halifax District; 502 - Sydney District; 503 - Cape Breton District; and 500 - Remainder of the Province. For ratemaking purposes, some companies divide the Province into more than these four statistical territories.

2.0 Automobile Insurance in Nova Scotia

[19] Automobile insurance is a mechanism whereby the insured pays a certain amount, the premium, in exchange for a contractual promise by the insurer to pay future covered claim amounts resulting from the use or operation of an automobile. "Insurance" is defined as follows in the **Insurance Act**:

> **3(k)** "insurance" means the undertaking by one person to indemnify another person against loss or liability for loss in respect of a certain risk or peril to which the object of the insurance may be exposed, or to pay a sum of money or other thing of value upon the happening of a certain event and includes life insurance;

[20] The **Act** also defines "automobile insurance":

> **104(c)** "automobile insurance" means insurance
>
> (i) against liability arising out of
>
> (A) bodily injury to or death of a person, or
>
> (B) loss of or damage to property,
>
> caused by an automobile or the use or operation thereof,
>
> (ii) against loss of or damage to an automobile and the loss of use thereof,
>
> and includes insurance otherwise coming within the class of accident insurance where the accident is caused by an automobile or the use or operation thereof, whether liability exists or not, if the contract also includes insurance described in subclause (i);

[21] Approximately 70 companies provide automobile insurance in Nova Scotia. As shown on Table I at page 4, no one insurance group or company has more than 18% of the automobile insurance market in Nova Scotia. MMC, in its actuarial report to the Board dated August 2002, advised that in 2001 the largest 10 insurance groups' share of the automobile insurance market in Nova Scotia was 86%, while in 1997 the largest 10 had

a market share of 72%. IBC confirmed that there have been a number of amalgamations and mergers in the industry in recent years. It asserts, however, that the industry remains competitive. Don Forgeron, Atlantic Vice-President of the IBC, testified at the hearing that:

> There is still a healthy level of competition. There is still a tremendous amount of choice for consumers out there. When they call a broker or an agent, there is still a wide variance in terms of pricing and I believe the MMC report clearly shows that there is quite a range of pricing available to consumers which, to me, is a sign that there is healthy competition in the marketplace. (Transcript, p.85)

[22] One of the insurance companies present, CGU Insurance Company of Canada, agreed that the number of automobile insurers has decreased in the Province, but is of the view that sufficient companies remain to ensure that the market remains competitive. One non-industry participant pursued the argument with each of the industry panels that reduced competition over the past several years is one of the reasons why rates are increasing. It was suggested that MMC should have studied whether or not decreases in competition have had an effect on rates.

[23] No information came to its attention in this proceeding which would suggest that the decline in the number of companies writing automobile insurance in Nova Scotia has had any material effect on current average premium levels in the Province.

[24] In 2001 total private passenger automobile insurance premiums written in Nova Scotia amounted to $330 million. Approximately 462,000 cars were insured in 2001 and the average premium per car was $715, up from $601 in 1997 (MMC Report, Section I, p.18).

[25] The private passenger (excluding farmers) class of automobile insurance, which is the class subject to this review, accounts for 85% of all automobile insurance

premiums written in Nova Scotia. There are several other classes of automobile insurance in Nova Scotia, including commercial, interurban trucks, taxis, motorcycles, buses and garages.

[26] The automobile insurance coverages which are available to consumers in Nova Scotia can be divided into those which are compulsory, meaning that the insured must buy them, and those which are optional. The first compulsory coverage is Third Party Liability (TPL). There are two parts to this coverage. Bodily Injury (BI) coverage protects the insured against liability arising from an accident which causes bodily injury to another person. Property Damage (PD) coverage protects the insured against liability arising from an accident which causes damage to the property of another person. The minimum permitted TPL coverage is $200,000. Additional TPL coverage is available on an optional basis. Most Nova Scotia automobiles are insured for $1,000,000 or more. The second mandatory coverage is Accident Benefits (AB). This is a no fault coverage which provides limited reimbursement to the insured for lost income, medical care costs and funeral costs. It also provides benefits to the dependents of a deceased person. The third mandatory coverage is Uninsured Motorist (UM) coverage. It protects the insured if bodily injury or property damage is caused by an at-fault driver who is unidentified or does not have insurance. The maximum UM coverage is $200,000.

[27] The following are optional coverages: Underinsured Motorist (UIM) coverage protects the insured if the insured is caused bodily injury by an at-fault driver who is insured, but does not have sufficient insurance to cover the liability. Collision generally provides coverage (subject to a deductible) for damage to the insured's vehicle arising out

of a collision. Comprehensive generally provides coverage (subject to a deductible) for damage to the insured's vehicle arising out of a peril other than collision. Examples are theft, vandalism, flood, hail and fire. Specified Perils and All Perils provide coverage (subject to a deductible) for damage to the insured's vehicle.

[28] In Nova Scotia, TPL coverage is provided by insurance companies in what might be described as a "tort" environment. In simple terms, the at-fault party must compensate the innocent victim of the accident for the personal injuries and vehicle damage sustained by the victim. Liability for the accident and the amount of compensation (damages) is determined in accordance with legal precedents established by the courts in prior cases. The at-fault party looks to his or her insurance company to pay the damages owing to the innocent party as provided for under the indemnity terms of the TPL coverage.

[29] The **Insurance Act** prohibits an insurance company from selling automobile insurance to occupational or professional groups or to associations at premiums which are lower than the members of the group would have to pay if they were insured by the company individually. A number of insurance companies have formed affiliated companies which sell only group automobile insurance in order to circumvent this requirement.

[30] There is increasing specialization among automobile insurance companies. The traditional, "regular market" companies sell automobile insurance through brokers or agents. A "non-standard" market has developed in Nova Scotia. Several insurers specialize in high-risk customers who might not qualify for insurance from some regular market insurers. Some insurers sell directly to customers, bypassing the need for brokers. As well, there are the group insurers mentioned above.

[31] IBC and the insurance company representatives who testified at the hearing acknowledged that the cross-selling or bundling of property and automobile insurance is "prevalent" in the industry. The Nova Scotia Designer Crafts Council (NSDCC) suggested in its final brief that automobile insurance is the "loss leader" when these products are bundled, meaning that automobile insurance rates are discounted to certain customers in order to obtain their more profitable property insurance business. The non-industry participants argued that the result of this practice is that the profitability of the automobile insurance sector is understated.

[32] The Nova Scotia Provincial Injured Workers Association submitted in its final brief that MMC should have explicitly considered cross-selling in its analysis. In response to a question at the hearing as to whether it is appropriate to take cross-selling into account in an actuarial analysis, Paula Elliott, FCAS, FCIA, a Principal and Consulting Actuary with MMC, responded as follows:

> In terms of determining private passenger automobile [rates], it would be inappropriate to include the data of personal property in that analysis because again there's [no] transfer of risk. However, if you're to look at your automobile portfolio and segregate it and say this group of risk[s] have a homeowners policy and this group of risk[s] do not and look at the loss ratio experience, your automobile loss ratio experience for those with a home and those without a home, and if it would show that there is a better loss ratio experience, that would suggest a discount would be appropriate, and that's what companies in this province and in other provinces are doing. (Transcript, p. 1720)

[33] The insurance company witnesses testified that cross-subsidization of one business line by another does not take place in the industry. They stated that insurers price insurance products in Nova Scotia, and in every province, based on each product line standing alone.

[34] The Board does not doubt that the insurance industry is offering discounts

to many customers who take both automobile and property insurance coverages from the same company. There is no evidence before the Board, however, that these discounts are not actuarially justified. If the argument is that the profits, or relatively lower losses, being achieved by the industry on property insurance should be taken into account when considering appropriate rates for automobile insurance, then the Board agrees with Ms. Elliott that each business line should stand on its own. That is the approach MMC took when developing its benchmark rates.

[35] At the hearing, several of the non-industry participants criticized IBC for not being more active in promoting accident prevention and road safety programs. They submitted that, if vehicle accident rates could be reduced, automobile insurance rates would go down. Mr. Forgeron agreed that IBC has some responsibility to support and engage in these types of programs. IBC indicated, in Undertaking U-1, that in the year 2001-2002, IBC "dedicated" $32,000 to road safety in Nova Scotia. In the past six years, including 2002-2003, it has dedicated $2.5 million to road safety in the Province. IBC has been active in Nova Scotia in promoting the graduated licensing program, and better driver training and other safety initiatives. It also participates on various provincial road safety and safe driving committees.

[36] The Co-operators General Insurance Company stated in its final brief that it participates in a number of road safety initiatives. It submitted that it is unreasonable to expect private insurers to spend the kind of money which the Insurance Corporation of British Columbia (ICBC) spends on road safety. ICBC is a Crown Corporation and has been mandated to perform certain functions that in other provinces are performed by

government departments. Co-operators made the additional point that:

> It is incongruous for participants in these hearings to advocate tighter expense controls for private insurers at the same time as they encourage multi-million dollar road safety expenditures. (Co-operators Post-Hearing Brief, p.4)

[37] Co-operators stated that it is in favour of an increased role for government in road safety education and in developing traffic safety initiatives.

3.0 Development of Insurance Rates

[38] In 1988, the Casualty and Actuarial Society adopted the "Statement of Principles Regarding Property and Casualty Insurance Ratemaking". Its purpose was to set out various principles applicable to the determination of property and casualty rates. The Statement defines ratemaking as follows:

> Ratemaking is the process of establishing rates used in insurance or other risk transfer mechanisms. This process involves a number of considerations including marketing goals, competition and legal restrictions to the extent they affect the estimation of future costs associated with the transfer of risk.

[39] The Statement goes on to point out that rates must be set on a prospective basis, because the rates must be in place prior to the transfer of the risk. It sets out four principles of ratemaking:

1. A rate is an estimate of the expected value of future costs.
2. A rate provides for all costs associated with the transfer of risk.
3. A rate provides for the costs associated with an individual risk transfer.
4. A rate is reasonable and not excessive, inadequate, or unfairly discriminatory if it is an actuarially sound estimate of the expected value of all future costs associated with an individual risk transfer.

[40] In order to determine the appropriate level of insurance rates necessary to pay claims, expenses, and earn a reasonable return on equity, insurance companies engage in a detailed process beginning with an overall actuarial analysis and ending with a review at the senior management level of each insurance company.

[41] Initially, an actuarial analysis is conducted by coverage (TPL, AB, etc.), on a Province-wide basis, to determine an overall indication of how much rates must change in order to be adequate. This analysis is based on the company's own emerging experience and data from the Green Book. Issues such as return on investment and competition are also considered when determining rates. Using the overall indications, the company then focuses on each territory and other risk classifications and determines which rate adjustments are necessary when compared to the overall indicated levels.

[42] Changes in underwriting practices within the company or changes in market conditions and competitors' prices are assessed by various groups within the company, including actuarial staff, branch, head office staff and marketing personnel.

[43] The rates actually charged by an insurance company are not necessarily the actuarially indicated rates. The final decision as to the amount of a premium increase and the timing of the increase lies with senior management. Competitive factors and market conditions are considered before final premiums are set.

[44] As mentioned above, Green Book data is used for information purposes by insurance companies when developing rates. Several non-industry participants at the hearing questioned the accuracy of the statistical data included in the Green Book. Gordon Adair testified that it is impossible to reconcile the information in insurance

companies' financial statements with Green Book information. He also testified that it is not possible to obtain a true and accurate picture of the insurance industry in Nova Scotia by relying entirely on the Green Book information compiled by IBC.

[45] In its evidence, IBC outlined the rigorous process and level of detail which is used to collect and reconcile the data used in the Green Book. IBC uses an Annual Balance Reconciliation (ABR) process, which is a requirement under the statistical plan, to ensure that the data provided by individual insurance companies is accurate and complete. IBC assesses penalties against reporting insurance companies if it determines that the information they have filed is inaccurate or incomplete. The ABR process requires a financial officer of each reporting company to sign the reconciliation form, and the forms require the company to provide the same written premium and loss information as filed in their P&C statements which are filed with the federal and provincial Superintendents of Insurance. IBC then compares the data on these forms and follows up on any discrepancies.

[46] The Atlantic Provinces Trial Lawyers Association (APTLA) expressed reservations about the AIX data in a letter to the Board. APTLA stated that the statistics compiled by the IBC were "significantly flawed". IBC responded:

> The Insurance Bureau of Canada (and its predecessor organizations) has carried out its role as Statistical Agent for the insurance regulators for over 70 years. IBC has developed, implemented and maintained effective rules, procedures, and systems to ensure the accuracy of the published industry automobile statistical exhibits. In addition to the review of the industry exhibits by internal IBC staff, all exhibits are also reviewed and approved for publication by an external consulting Actuary.
>
> The published automobile exhibits are based on reporting requirements that are approved by the provincial/territorial insurance regulators. In Ontario, the Financial Services Commission of Ontario (FSCO), also reviews and approves all published industry exhibits. It is our understanding that FSCO and all other provincial/territorial insurance regulators who have appointed IBC as their Statistical Agent have not expressed these concerns.
>
> (IBC Response to Board IR-18)

[47] The NSDCC also had concerns with the IBC data, and in particular questioned the validity of MMC's conclusions on the basis that MMC relied on this data source. NSDCC criticized MMC on the ground that MMC "didn't do their own review of the data".

[48] MMC responded that it has no reservations about using Green Book data. Ms. Elliott stated at the hearing that this data is accepted by all Canadian regulators because they recognize that the process followed by IBC's Insurance Information Division is thorough and that the information is subjected to a variety of tests.

[49] The Board is satisfied that it was entirely appropriate for MMC to use Green Book data for purposes of preparing its actuarial report. Green Book data has been used for decades by industry actuaries and actuaries in government for purposes of developing or testing rates. It should be noted that MMC did not rely on IBC estimates of loss development factors and loss costs contained in the "AIX" exhibits, but used its own judgment to determine appropriate estimates for these ratemaking elements.

4.0 Analysis of Private Automobile Insurance Rates in Nova Scotia

4.1 MMC's Report - Major Findings

[50] MMC conducted a study of automobile insurance rates in Nova Scotia and submitted its findings in a report, dated August 2002, entitled *Nova Scotia Private Passenger Automobile Insurance Review*. Its major findings were as follows:

> 1. **Based on our analysis, and the information we have been provided and the assumptions we have made, in general, private passenger automobile insurance**

premiums in Nova Scotia appear to have been inadequate for at least the past five years. Despite large premium increases since 2001, further premium increases appear to be indicated. Based on our analysis, current average premiums appear to be approximately 10 percent to 20 percent below the level necessary for insurance companies to achieve an assumed after-tax total return on equity of 10.percent. The indicated premium inadequacy of 10 percent to 20 percent is subject to many underlying assumptions, and based on industry averages in a marketplace that is undergoing significant premium changes.

2. In general, it has been the Third Party Liability (TPL), Accident Benefits (AB), and Uninsured Motorist (UM) coverages that have contributed most to the industry's apparent unprofitable results, and the current average premiums for TPL appear to remain most inadequate. In general, the premiums charged for the physical damage coverages, Collision and Comprehensive, appear to have been, and continue to be, relatively profitable.

3. Of the factors that cause insurance costs to rise: the incidence of automobile claims (claim frequency), the cost of automobile insurance claims (claim severity), and insurance company operating expenses, it has been claim severity that has been the primary cost driver. We project the average TPL claim severity will increase by approximately 10 percent between 2001 and 2002. The increases in claim severity experienced in Nova Scotia mirror increases that are occurring in other provinces. Lower investment yields further impacted the insurance industry's profitability.

4. The apparent general inadequacy of automobile insurance premiums, the continued escalation of average claim costs, and the relatively low investment returns, suggest that, on average, insurance premiums will continue to rise in Nova Scotia over the near term. For some companies, however, current premiums seem to be at, or near, adequate levels.

5. Perhaps as a result of these general financial results, the volume of risks in the Facility Association in Nova Scotia has more than doubled since 1999.

6. Our analysis suggests that when compared to their underlying costs, youthful operators, generally, are being charged relatively more than other drivers. In addition, there is some evidence of more restrictive underwriting being put in place that is aimed at youthful operators, and to some extent, senior age drivers. Otherwise, we find no evidence of discriminatory rating or underwriting practices in the province. (Exhibit A-31, Section I, pp. 2-3)

[51] MMC performed an actuarial analysis of the historical automobile loss experience of insurance companies operating in Nova Scotia, as published by IBC, and developed "benchmark premiums" by coverage for the year 2002. Benchmark premiums are the average premiums that would have had to be charged by insurance companies in Nova Scotia in 2002 to achieve the target return on equity (ROE). The benchmark premiums were then compared to actual premiums to determine rate adequacy.

[52] In developing the benchmark premiums, MMC considered the rate of increase in automobile insurance losses in Nova Scotia, provided for operating costs, and used a target after-tax ROE of 10% to develop a profit margin. MMC indicated that the target 10% ROE is within a range used by other insurance regulators. In developing the profit margin, MMC assumed an investment yield of 5.66%, which MMC had calculated to be the average pre-tax yield on ten-year Government of Canada bonds for the last five years.

[53] In order to assess the relative adequacy of premiums being charged to individual risks, MMC extended the benchmark premiums, by coverage, to type of risk. MMC did so by conducting an actuarial analysis of the loss experience of companies operating in Nova Scotia, as published by IBC, by the major risk characteristics: rating territory, driver classification, driving record, vehicle type, and amount of insurance coverage. Based on this analysis, MMC developed "benchmark base premiums" and "rate differentials", which were compared to ten risk premium profiles in each of the four statistical territories in the Province to assess the reasonableness of the current premiums being charged for each risk profile.

4.2 Premium Increases and Claim Cost Experience, 1997-2001

[54] The purpose of this section of the Board's report is to compare premium increases with increases in the cost of claims over the period 1997 to 2001 and to identify the principal causes for the increases in claim costs.

[55] MMC's analysis indicates that automobile insurance premiums in Nova Scotia were stable from 1997 to 1999, rising only 1% over this period. The average premium rose 4% from 1999 to 2000 and then jumped 14% from 2000 to 2001. Over the whole five year period, the cumulative increase in premiums was marginally less than 20%.

[56] By way of introducing this discussion, the following table, filed as Undertaking U-8 by IBC, is of interest. It shows Transport Canada reported motor vehicle traffic collisions in Nova Scotia for the period 1990 to 2000:

1990 - 18,808	1995 - 15,651
1991 - 19,778	1996 - 13,983
1992 - 18,906	1997 - 14,665
1993 - 18,646	1998 - 14,464
1994 - 17,819	1999 - 15,129
	2000 - 14,893

[57] The intriguing point about this table is that it shows the number of collisions since 1997 has been relatively flat. These statistics raise an obvious question. If there has been no significant increase in traffic collisions in recent years, *why* have premiums increased to the extent they have? The answer to this question lies in the information in MMC's actuarial report relating to claim costs and particularly the two components of claim costs - claim frequency and claim severity.

[58] In its discussion of "cost drivers", MMC reached the following general conclusion:

> There are three main cost drivers, or causes, of the private passenger automobile costs that are incurred by insurance companies. They are: claim frequency, claim severity, and operational expenses. (Note, the number of insured drivers and the amount of coverage purchased are other cost drivers, but our analysis suggests that these have not been major causes of the increased costs that companies have experienced in Nova Scotia.)
>
> As shown in the following charts, of the three major drivers, claim severity has been the primary cause for the increases in insurance costs over the past five years.
>
> (MMC Report, Section I, p. 31)

[59] Claim frequency is the average number of claims that occur in a year, per insured vehicle. It is thus a measure of the incidence of automobile insurance claims. Claim severity is the average incurred loss and ALAE (allocated loss adjustment expense) per claim. It is a measure of the average cost of automobile insurance claims. Loss cost or claim cost per automobile is the average incurred loss and ALAE in a year per insured automobile. It is the product of claim frequency and claim severity.

[60] Looking first at claim frequency, the MMC report indicates that there has been no meaningful change in frequency of claims for TPL between 1997 and 2001. Theodore Zubulake, FCAS, MAAA, FCIA, a Managing Director of MMC and a Consulting Actuary, described the "frequency rates" as being "relatively level" over the five year period. This statement would seem to be quite consistent with the road collision figures set out above.

[61] Turning to claim severity, MMC has demonstrated that with respect to TPL - bodily injury, claim severity (i.e., average cost per bodily injury claim) increased by over $13,000 during the five-year period from 1997 to 2001; while the increase in severity for each of TPL - property damage, accident benefits, and physical damage (principally collision and comprehensive), during this same period was less than $1,000.(MMC Report, Section II, "Ultimate Losses and Adjusting Expenses, Summary Statistics")

[62] It should be noted that in 2001 the bodily injury category of claim costs represented about 59% of total claim costs.

[63] In terms of the combined effect of the changes in claim frequency and claim

severity, (i.e., loss or claim cost per automobile), MMC has determined that the cumulative increase in loss cost was 51% for TPL - bodily injury, 43% for TPL as a whole, and 33% for all coverages combined over the five year period, 1997-2001. The following table prepared by MMC, based on data which appear in its exhibits to Section II of MMC's report, shows the cumulative increases in loss cost since 1997 separately for bodily injury, TPL as a whole, and all coverages combined.

TABLE II

Accident Year	TPL Bodily Injury	Cumulative % Change	TPL Total	Cumulative % Change	All Coverages	Cumulative % Change
1997	$257		$320		$477	
1998	$298	16%	$362	13%	$509	7%
1999	$349	36%	$418	31%	$591	24%
2000	$379	48%	$448	40%	$648	36%
2001	$389	51%	$457	43%	$635	33%

4.2.1 Board Findings - Premium Increases and Claim Cost Experience, 1997-2001

[64] The evidence is clear that premium increases (20%) lagged claim costs increases (33%) over the period 1997-2001. MMC stated that it did not know why this happened but suggested that "It may, in part, be attributed to a desire on the part of companies to increase market share, or it may, in part, be attributed to reliance upon investment income to generate target revenue". The Exactor Report, prepared by Ronald

R. Miller, FCAS, FCIA, of Exactor Insurance Services Inc., and filed with the Board as part of IBC's pre-filed evidence, suggested that the premium increases from 2000 to 2001 "presumably reflects insurers having recognized, as data from recent years matured, the large and sustained recent positive trends in claim costs, together with the deteriorating investment climate". The Economical Insurance Group submitted in its post-hearing brief that:

> Nova Scotians have benefitted from insurance rates below the actuarially indicated rates because of the highly competitive insurance market in Nova Scotia. Insurance companies tend to set rates below the actuarially indicated premium levels in order to retain or gain market share. (Economical Post-Hearing Brief, pp.1-2)

[65] The Board considers that the evidence is convincing that the principal cause of increased claim costs over the 1997-2001 period was claims for compensation for bodily injuries. The evidence examined by the Board shows that third party liability claim costs, and particularly, TPL bodily injury claim costs, have been increasing much faster than collision and comprehensive claim costs.

4.3 Soft Tissue Injuries

[66] While pointing out in its pre-filed evidence that there are a number of factors which account for the current level of insurance costs, among them the level of taxation, general inflation, insurance fraud and health care costs, IBC placed particular emphasis on the cost of settling claims for soft tissue injuries such as whiplash. IBC referred specifically to the "Nova Scotia Private Passenger Automobile Insurance Tort Bodily Injury 2001 Closed Claim Survey", prepared for it by Exactor and published in January, 2002. The report was filed with the Board in IBC's response to Board IR-21. The study reviewed

540 completed claim files each of which involved a compensation claim for bodily injury. The study concluded, among other things, that soft tissue injury claims represented 70% of all bodily injury claims reviewed in the study and 56% of the money paid out. The majority of this money was for pain and suffering (67%) rather than for economic loss. Based on the study, IBC concluded that:

> The primary factor behind rising auto insurance claim costs was a significant increase in the cost of settling less serious soft tissue injury claims, and specifically the cost of pain and suffering awards. (Exhibit A-1, IBC pre-filed evidence, pp. 5-6)

[67] While the IBC survey was not extensively examined at the hearing, the non-industry participants questioned a number of its premises and findings. The following exchange between the Board and Mr. Miller is noted:

> Q. . . . but to get from there [increases in the cost of bodily injury claims] to the statement or the proposition that the increases have been caused in respect of soft tissue injury claims, ... you would agree with me, would you, that one doesn't get that information from the Green Book data, one has to look to the - I suppose the knowledge and experience of people involved in the insurance industry, anecdotal kinds of accounts, plus the results of the closed claim study that you've referred to, Mr. Forgeron. Is that a fair summary of how things unfold here?
>
> A. (Miller) Yes, that's a fair summary. That's correct. And the statistical plan does not code any information about how third party bodily injury claims [are] split by head of damage, like pain and suffering versus - or by type of injury like soft tissue. It's just not there, so you have to go to those other sources. (Transcript, p. 529)

[68] The Board makes no finding with respect to the closed claim study. However, the study may warrant more critical scrutiny for the purpose of any future discussion of possible steps to mitigate increasing insurance premiums.

4.4 Operating Expenses

[69] Property and casualty insurers define operating expenses as general operating expenses other than ALAE (allocated loss adjustment expense) and ULAE (unallocated loss adjustment expense). In other words, operating expenses are those expenses which do not relate directly or indirectly to the cost of settling claims. The principal categories of operating expenses are commissions paid to agents and brokers, general administration, taxes, licences and fees.

[70] MMC found that the expense ratios (operating expenses divided by written premiums) for Nova Scotia private passenger automobile insurance varied from 1997 to 2000 as follows:

1997 - 27.8%
1998 - 27.3%
1999 - 28.8%
2000 - 26.9%

(Exhibit A-33)

[71] MMC noted that commission expenses have been slightly higher in Nova Scotia over the period 1997 to 2000 than for the country as a whole while general expenses have been slightly lower in Nova Scotia than for the country as a whole. MMC also noted that automobile insurance is more likely to be written by direct writers (who do not have to pay commission to brokers) in Ontario than in Nova Scotia, and, given the large size of the Ontario market, this could explain at least in part why commissions are somewhat higher in Nova Scotia.

[72] When asked to justify the level of operating expenses in the industry, Mr. Forgeron replied that:

> ... controlling costs, quite frankly, has not been an issue in this industry. It's a very efficient industry that relies heavily on technology and I don't think we've seen any huge increases in those expenses over the years to warrant any closer scrutiny. (Transcript, pp. 564-565)

4.4.1 Board Findings - Operating Expenses

[73] MMC's and Exactor's evidence indicates that operating expenses expressed as a percentage of premiums have been essentially stable in recent years. The explanation for the increasing premiums being experienced by Nova Scotia consumers must be found elsewhere. The Board would note that IBC submits that the property and casualty industry is one of the most highly taxed industries in Canada. These costs, like general government compliance costs, which the industry also claims are onerous, are ultimately passed on to consumers.

4.5 Reserves

[74] As part of its analysis, MMC reviewed the case reserve levels of the companies which it surveyed. A reserve is defined by MMC as ". . . the aggregate provision identified by an insurance company for the payment of future losses and claim related expenses associated with claims that have been incurred". A *case* reserve is defined by MMC as ". . . the provision established by insurance companies for the payment of future losses and claim related expenses associated with a particular claim". Bulk reserves are those reserves which relate to claims for accidents which have been incurred but not reported. Known as IBNR reserves, they are also considered in the ratemaking

determination. Mr. Zubulake indicated that "In a true sense, the term IBNR does refer only to the late-reported claims, the provision for late-reported claims. But over the years that definition has been expanded to include the deficiencies in case reserves, as well, on other known claims, and that is also referred to as a bulk reserve, the combination of both". Mr. Zubulake testified that "We had provided for late-reported claims and what we believed to be deficiencies in the case reserves based on the actuarial analysis we performed". He further testified that MMC factored into its calculations the expanded definition of IBNR. While MMC used the individual companies' case reserves as reported to IBC, it did not verify them. Further, MMC did not use the individual companies' estimates of their IBNR, as it made its own independent estimate of the industry's required IBNR.

[75] MMC, on page 39, Section I of its report, stated the following:

> We examined the aggregate insurance industry loss development experience as compiled by the IBC to see if there was any evidence of [case] reserve strengthening that should be reflected in our estimates of the ultimate losses and ALAE that will be incurred by the industry. We found there to be no such evidence on an industry-wide basis.

[76] Barry Mason, Counsel for Nova Scotia Provincial Injured Workers Association, submitted that if a company wanted to show higher losses it could simply increase its reserves. He indicated that, in 2001, CGU had done just that.

[77] CGU stated in Undertaking U-13 that the CGU Group increased its reserves in Nova Scotia by approximately $9.5 million from 2000 to 2001. Mr. Mason suggested that the company should have increased reserves sooner because it ought to have been known, based on prior claims history, that reserves needed to be increased. Karl Driedger, Senior Vice President of CGU, stated that CGU had not expected that the trend would

continue. Then, in 2001, CGU realized that the trend was continuing, and the company received a second opinion from an independent actuary who confirmed that it was necessary to increase the reserves in 2001.

[78] In their final submissions, a number of non-industry participants suggested that insurers could potentially increase their reserves in order to reduce profits. In response to this, IBC stated, in its rebuttal, that there was no evidence presented to prove that companies have manipulated their reserves.

4.5.1 Board Findings - Reserves

[79] The Board recognizes that MMC has not done a detailed review of the reserve methodologies utilized by each of the surveyed companies. However, the Board accepts MMC's conclusion that, based on its limited review, there is nothing to indicate that the companies were inappropriately increasing their case reserves so as to distort the aggregated case reserves used by MMC in its analysis. The Board notes that no evidence to the contrary was presented at the hearing.

4.6 Investment Income

[80] In addition to receiving revenue from insurance premiums, a property and casualty insurance company receives income from its bond holdings and other investments. IBC's evidence indicates that almost 85% of property and casualty insurance companies' investments are in government and corporate bonds and preferred shares. Mr. Forgeron pointed out that investment income represents about 15% of an insurer's

total income with the other 85% coming from premiums. IBC stated that "even a large increase in investment income will not compensate for weak underwriting results". A property and casualty insurance company earns income on the investment of the premiums received from policyholders, from claim reserves and on the investment of its equity.

[81] In developing its benchmark rates, MMC used a return on investment (ROI) based on a five year average of the before-tax yields of ten-year Government of Canada Bonds. MMC went on to say that:

> The ROI used in this study is 5.66%. Based on information provided by insurers to us, we suggest this return on investment assumption is in-line with the rates assumed by insurers in their pricing models. (MMC Report, Section II, p. 8)

[82] IBC's actuary assumed a ROI of 5.5%. With respect to investment income, IBC stated:

> Investments in today's market don't help the situation either. Insurance companies generate some of their income by putting collected premium dollars into short-term secure investments. With today's investment returns, that doesn't add much to the money needed to pay claims, and premiums alone have not been sufficient to cover claims and related operating expenses. (Transcript, p.19)

[83] Both MMC and IBC based their ROIs on what rates are expected to be in the future. The Nova Scotia Provincial Injured Workers Association stated that 8% should have been used as the ROI because historically this was achievable.

[84] The Nova Scotia Provincial Injured Workers Association, in its closing submission, stated:

> The statistical analysis prepared by MMC Enterprise Risk projects that insurers will continue to receive lower rates of interest in the next few years. In Undertaking 36, MMC Enterprise Risk writes that they assumed an investment income rate of 5.66%. However, at page 63 of Section 1 of MMC Enterprise Risk's report, they note that the average investment income reported in the P & C-1 Exhibits by the insurance companies was approximately 8%. If an

8% interest rate is used rather than 5.66%, then MMC Enterprise Risk states that the industry would be required to increase their existing rates by 10% in order to achieve a 10% return on equity (See Undertaking 36).
The above clearly demonstrates that small increases in the interest rate for investment income will lead to significant increases in profitability for insurers. The fact that the economy has been depressed over the past few years has led to lower investment yields and has affected the profitability of automobile insurers in Nova Scotia.

(Closing Submission, pp. 2-3)

[85] Then, on page 6, paragraph 7, the Association concluded:

MMC Enterprises Risk employed an interest rate on investment income of 5.66% which ought to have been 8% when taking into account the historical rate;

[86] The Nova Scotia Coalition Against No Fault Insurance, in its rebuttal brief, stated:

Reasonableness of Investment Return Assumptions:

The IBC suggests that it is reasonable to use a lower projected return on investment income because long-term bond rates are lower than they have been in the past. With respect, that is not the point raised by the Coalition.

The evidence established that, in the past, the insurance industry **has always** exceeded its projected return on investment income. The Coalition questions why the industry has not learned from its experience when projecting anticipated investment returns in the future.

Simply put, The Coalition feels that projected investment returns have been understated by the industry in order to support excessive rate increases. (Rebuttal Submission, p. 3)

4.6.1 Board Findings - Investment Income

[87] The Board is of the view that it was appropriate for benchmarking purposes to use a projected ROI of 5.66%, as was done by MMC. While the Board agrees that historic rates of return on investment have been significantly higher than at present, there is no certainty whatsoever that in the near future rates will return to former levels. Benchmark rates are intended to reflect projected future conditions, and as such, it is more

appropriate, in the Board's view, to use current average rates of return on 10 year bonds in the calculation of the benchmark rates.

[88] As to why a current rate of return on investment should be used rather than a rate earned in the past, the Board agrees with Mr. Zubulake's explanation as follows:

> Again, we're making rates for the policy of 2002, so the question we need to address is what investment returns can the companies make on the new monies that they will receive, the premiums that they will collect during 2002. You know, they can't buy 11 percent earning - interest earning - bearing bonds any more, so that is where we're using a five and a half, a 5.6 percent investment rate because that is probably what is a reasonable expectation of their investment yields for the new money that they'll be getting in 2002.
>
> And that old money that they've invested is used to pay, hypothetically, the old claims. You know, had we been doing a study of rates needed for the year 1992, just picking a number now, we would have used the prevailing interest rate then which [was] maybe closer to 10 percent or much higher than the 5.6% we're using now. (Transcript, pp. 1517-1518)

4.7 Industry Profitability

[89] Donald Forgeron testified that:

> The insurance industry in this province has not been profitable for most of the last decade. Insurers have posted losses on auto insurance in 10 of the last 12 years, including the past six consecutively. (Transcript, p. 19)

[90] Mr. Forgeron also stated that:

> Historically P&C insurance in Canada generated a long-run average return on equity of 10 percent, and...the industry in Canada as a whole posted a return on equity of 3.1% in 2001, the lowest level ever recorded. (Transcript, p. 19)

[91] In its direct evidence, the IBC stated the following:

> In Atlantic Canada, and Nova Scotia specifically, losses on automobile insurance extend through most of the 1990's. (Exhibit A-1, p. 21)

[92] Exhibit 7 to Section III of MMC's report summarizes the estimated actual (historical) profit/loss realized by the automobile insurance companies doing business in

Nova Scotia for accident years 1997 to 2001 for private passenger automobile insurance. The Board has summarized the financial results for these years, including loss ratios and pre-tax return on equity, as follows:

TABLE III

Province of Nova Scotia - 2002 Private Passenger Benchmark
Summary of Financial Results by Accident Year Including Loss Ratios

Year	Profit (Losses)	Loss Ratio	ROE
1997	$-5,882,000	89%	-3%
1998	$-23,427,000	95%	-13%
1999	$-58,198,000	110%	-40%
2000	$-78,030,000	118%	-53%
2001	$-58,440,000	106%	-38%
	$-223,977,000		

[93] The Board considers that the losses incurred in Nova Scotia in the years 1999 to 2001 are particularly striking and provide an insight into why rates have been rising so dramatically over the last couple of years.

[94] The Economical Insurance Group stated in its direct evidence that:

> ... Economical Mutual Insurance Company has had a negative return on equity for four out of the five years from 1997 to 2001, with one year generating a minimal positive return. In financial terms, this translates to an estimated net loss of $11.3 million dollars over 5 years, after accounting for investment income, as shown in Exhibit 2. (Exhibit A-15, p. 3)

[95] Mr. Driedger, of the CGU Group, stated in his pre-filed evidence (Exhibit A-8) that the CGU Group is one of the leading property and casualty groups in Canada. It was formed in 1998 following the merger and amalgamation of the General Accident Assurance

Company of Canada, Canadian General Insurance Group and Commercial Union Assurance Company of Canada. Its principal operating company in Nova Scotia, CGU Insurance Company of Canada, (CGU), had about an 11% market share of the automobile insurance market in Nova Scotia in 2001.

[96] CGU's loss ratio on automobile insurance in Nova Scotia deteriorated from 70% in 1999, to 97% in 2000, to 115% in 2001. Loss ratio is defined as incurred losses and ALAE divided by earned premium. It is a common measure of premium adequacy. Mr. Driedger stated that CGU currently targets an after-tax return on equity of 10%. To achieve that level of return CGU requires premiums which will reduce its loss ratio to 75% assuming an investment yield of 5%, a premium to surplus ratio of 2:1, an income tax rate of 42% and an expense ratio of 27%. CGU employs the same target return on all its lines of business. From December 2000, to the date of the hearing, CGU increased its private passenger automobile insurance rates in Nova Scotia by 42%.

[97] The Co-operators Group (Co-operators) operates in Nova Scotia through three companies. It is owned by 29 Canadian co-operatives. Its principal operating company in Nova Scotia is Co-operators General Insurance Company. It has about 5% of the Nova Scotia market. It stated in its pre-filed evidence that it has lost money on private passenger automobile insurance in Nova Scotia in each of the years 1997 to 2001 and that it lost "$8.9 million on the Nova Scotia automobile product over the last three years".

[98] Co-operators stated that its loss ratios were 98.2% in 1999, 113.7% in 2000 and 99.0% in 2001. It notes that it has been able to reduce its fixed expense from 18.1%

in 1999 as a percentage of premium to 14.9% in 2001. Its overall expense ratio in 2001 was 24.4%. Its "strategic plan" calls for an after-tax return on equity of 12% although it does not expect to achieve this return based on the last review it conducted prior to the hearing. Assuming a 10.4% rate of return on equity, Co-operators calculated that an overall rate increase of 40% would be required for the next six-month period "to bring us to rate adequacy". Andrew Cartmell, Vice-President of Personal Lines and appointed actuary for Co-operators General Insurance Company, had this to say in his opening statement with respect to escalating premiums:

> We have reviewed our claims handling costs. We've tightened our belts. But the real source of the problem is not expenses or low investment returns. It's the skyrocketing cost of claims. For both liability and accident benefits we've experienced double digit loss cost trends. (Transcript, p. 754)

4.7.1 Board Findings - Industry Profitability

[99] For insurance companies writing private passenger automobile business in Nova Scotia in recent years, the financial results have been nothing short of abysmal. Their earnings from this line of business have not been adequate by any reasonable standard. It is not surprising that the automobile insurers have been taking drastic rate action to restore profitability. The next section of this report deals with an important measure of profitability, rate of return on equity.

4.8 Rate of Return on Equity (ROE)

[100] Return on equity is usually calculated by dividing the net profit after taxes available to common shareholders by the value of the common equity in the company.

Insurers make use of a "target" rate of return when developing rates for a line of business such as private passenger automobile insurance. In setting rates, the insurance company must include a profit margin in its rates if it is to make any profit on the coverages it provides. In order to determine a profit margin, the insurance company must first select a target ROE.

[101] On December 9, 2002, the Board circulated to all participants a schedule which indicates, on an "anonymous basis", projected ROEs of the various insurance companies which were surveyed by MMC. The projected ROEs are based on the rate levels in effect at July 1, 2002. The range of projected ROEs varies from a high of 15% to a low of -20%. The weighted average, as calculated by MMC, is a ROE of 4%. Of the 25 responding companies, nine projected ROEs of more than 10%, seven projected ROEs of 0% to 10% and nine projected negative returns. A number of the participants emphasized in their closing submissions that, in fact, a number of the companies are now generating profits which in some cases are exceeding a ROE of 10%, and they argued that these rates should not be allowed to increase further. IBC, on the other hand, pointed out in its closing submission that the average of all of the ROEs was only 4%, which was "... well below an adequate rate of return as identified by Mr. Miller and MMC".

[102] In Section II of its report, Exhibit A-31, at pages 7 and 8, MMC said the following concerning rate of return:

> We have assumed an after tax ROE of 10 percent for purposes of this analysis. We note the Newfoundland Board of Commissioners of Public Utilities uses a target of 8.5 percent for its 2002 benchmarks, and the Financial Services Commission of Ontario will be retaining expert opinions from economists in a new study it will be commissioning, as it believes its current assumption of 12 percent should be studied.

[103] The non-industry participants suggested that, because the insurance industry in the aggregate has not achieved a 10% ROE for many years, and insurance companies have lived with much lower returns, it is unreasonable for insurance companies to target a 10% after-tax ROE.

[104] In its rebuttal submission, The Nova Scotia Coalition Against No Fault Insurance, stated:

> **Reasonableness of 10% Return on Equity:**
> The Board has the power to order an adjustment of rates if it finds, based on the evidence before it, that rates are unreasonable.
>
> We would submit that one of the questions that the Board will have to consider is what is a "reasonable" Return on Equity (ROE). IBC uses a benchmark ROE of 10.5%. MMC used a benchmark of 10%. Ms. Elliott stated that the benchmark of 10% was used because it is the same that is used in other jurisdictions.
>
> We would submit that what is reasonable is not an absolute measure. Simply because a target is used in other jurisdictions is not, by itself, a satisfactory measure of reasonableness.
>
> Furthermore, what is reasonable must be looked at in historical context. The 10% "benchmark" is one that the industry has used for more than a decade. Using a target ROE of 10% five years ago when equity markets worldwide were doing well may have been reasonable. Using a target ROE of 10% when the global economy is lagging is not reasonable.
>
> In short, what is "reasonable" is not an absolute measure and changes with time and location. (Rebuttal Submission, p. 4)

[105] In its closing submission, the Nova Scotia Provincial Injured Workers Association stated:

> **Ten Percent Return on Equity:**
> MMC Enterprise Risk in its analysis of the adequacy of insurance rates in this Province used the figure of 10% as the appropriate return on equity for insurers. However, the industry as a whole has not achieved this rate of return over the past 10 years. If the return on equity is reduced, then the requirement for insurers to increase their premiums in this Province is similarly reduced. It is respectfully submitted that the Board should not use the figure of a 10% return on equity as the appropriate return in assessing the reasonableness of insurance rates in this Province. (Closing Submission, p.4)

[106] The Economical Insurance Group, in its post-hearing brief, stated that:

> In order to survive and to provide security to its customers, insurance companies need to attract and retain capital. In order to do this, they need to generate a fair return on equity. This necessitates in the case of the Economical Insurance Group the need to raise its rates. Even with the raising of rates, Economical Insurance Group is not likely to meet its target of 10 percent return on equity in the foreseeable future. [Exhibit A-17]
>
> . . . In our submission, the evidence before the Board supports the conclusion that the current rate levels are not excessive and in fact are not adequate to ensure companies attain a reasonable return on equity. (Post-Hearing Brief, p. 2)

[107] The Board asked the IBC panel to justify the use of an after-tax ROE of 10% when, as pointed out countless times by the non-industry participants, the industry (with individual exceptions) as a whole has not managed to earn a positive ROE on automobile insurance business in Nova Scotia since at least 1989. Mr. Miller's response is of interest:

> I guess insurers who have been operating auto insurance in Nova Scotia in the current marketplace where their rates haven't been regulated or frozen or held down or things like that can take solace in the fact that they have internal target returns on equity. Let's say, for the sake of argument, they might be 10 or 12 percent. They may not have achieved - individual insurers may have achieved [such] returns in some years. This is the industry as a whole. But they can take solace in the fact that in the current environment, they have the opportunity to attempt to earn what they think is a reasonable return on equity subject to competition and so on.
>
> If regulation were to be imposed that basically capped or controlled insurers' rates so that there was a controlled rate of return - I don't know what number you might think was appropriate if you might think that 10 percent wasn't - let's say for the sake of argument five percent was taken as a reasonable target - then I think you might expect that many insurers would not wish to continue doing business in the Province of Nova Scotia, and I think you would end up in a situation where you would have much reduced competition and other issues that go with that. (Transcript, pp. 508-509)

[108] As set out later in this report, MMC determined that, to achieve the assumed after-tax ROE of 10% in 2001, the average 2001 earned premium would have been 47% higher than it actually was. To give some indication of the sensitivity of earned premium inadequacy to return on equity, MMC calculated that, using an assumed rate of return of

7.5%, the earned premium inadequacy would have been approximately 43% and, at an assumed rate of return of 5%, the earned premium inadequacy would have been about 38%.

4.8.1 Board Findings - Rate of Return on Equity

[109] The Board does not accept the argument put forward by the Nova Scotia Provincial Injured Workers Association to the effect that, because the industry as a whole has not achieved a 10% ROE over the last 10 years, it is therefore inappropriate to use a target ROE of 10% for benchmarking purposes.

[110] It is clear to the Board that the private passenger automobile insurance business in Nova Scotia has been unprofitable because the rates in recent years have been too low for the companies in the aggregate to earn an adequate return.

[111] It is also clear to the Board, based on the evidence before it, that the principal reason why the industry has been unprofitable is that there have been significant increases in automobile claim costs, and the industry was slow to respond to these increasing costs by increasing premiums.

[112] MMC has used a target rate of return of 10% in the calculation of benchmark rates. The Board has seen no evidence to persuade it that the benchmark rate of 10% is unreasonable. Accordingly, the Board finds, that for benchmarking purposes, a target ROE of 10% is appropriate.

4.9 Premium Adequacy and Future Claim Costs

[113] Based on its actuarial analysis at the industry-wide level, MMC found that automobile insurance premiums in Nova Scotia were inadequate for at least the period 1997 to 2001. It concluded that for the industry to have met a target ROE of 10% in 2001, premiums should have been 47% higher than the average premium charged in 2001. MMC further found that after taking into account the increases which had already occurred in 2002 to the date of its report in August 2002, average premiums for the year 2002 were still approximately 10% to 20% below the level necessary to achieve an after-tax ROE of 10%.

[114] The Board takes particular note of MMC's comments with respect to future increases in claim costs and the need for continuing premium increases. MMC calculated annual loss trend rates to project "current data and project it forward". MMC determined a trend rate or factor of 10.0% per year for TPL - bodily injury, and 9.7% for Accident Benefits. These trend factors may be contrasted with MMC's much lower trend factors for TPL - property damage of 5.1%, 4.3% for collision and 4.1% for comprehensive. For all coverages, MMC determined a weighted average loss trend rate of 7%. As to what an overall loss trend of 7% portends for the future, Mr. Zubulake made the following comment:

> As we've said earlier, we were seeing cost increases at an annual rate of, depending on the coverage, five to 10 percent a year. So, even if companies raise their rates to achieve rate adequacy in 2002, costs will further increase as we go from 2002 to 2003 and further increases, everything else being equal, would be necessary to keep up with the cost increases that are arising. So, if you're asking will we see further increases, are we done with the rate increases, even if companies have all caught up to our 2002 level, adequacy level, there'll continue to be a need for rate increases next year to keep up the loss cost trends that are occurring. (Transcript, pp. 1701-1702)

[115] Mr. Zubulake added:

> So, unless something changes, claim costs will - based on history, will continue to increase at the rate of seven percent a year... (Transcript, p. 1701)

4.9.1 Board Findings - Premium Adequacy and Future Claim Costs

[116] The Board has carefully weighed the import of Mr. Zubulake's comments. MMC's trend rates were not seriously challenged, much less refuted, at the hearing. It is noteworthy that MMC calculated its severity trend for TPL on the basis of ten years experience and did not just consider the more recent years of experience. The Board concludes, for the reasons set out in this report, that continuing cost increases, and therefore, premium increases are to be expected as long as the existing automobile insurance system in Nova Scotia remains as it is today.

4.10 Restrictive Underwriting Practices

[117] During the hearing, non-industry participants raised the issue of restrictive underwriting practices being put in place by the insurance industry, especially with respect to youths and seniors.

[118] MMC reviewed the rating manuals and underwriting policies contained in the manuals of the 28 companies which it surveyed. MMC found evidence of more restrictive underwriting practices with respect to youths and seniors, and that rates for youthful drivers are higher than other drivers when compared to their underlying costs.

[119] MMC made the following observations with respect to youths and seniors

arising from its review:

> Our review of the underwriting manuals of the surveyed companies reveals some companies having special underwriting eligibility rules that are targeted to the youthful or senior drivers. Some examples:
>
> - A principal operator under 25 or age 71 or older must be written in the group's substandard market company
> - A principal operator with less than 5 years of proven driving experience is not written
> - Drivers under 21 or age 70 or over must be referred to the company before an agent can bind coverage
> - A principal operator under age 25 having one or more moving violations in the last three years is not eligible for insurance coverage.
>
> In addition, two of the surveyed companies use a risk point chart to determine eligibility. The points are based on risk factors such as number of convictions, at-fault losses, cancellations for non-payment or non disclosure, having no prior insurance, young drivers with sports cars, inexperienced drivers and drivers with serious illnesses or disabilities that would affect their driving. Also, in one case, principal operators over 70 years of age who also meet criteria regarding convictions, accidents, etc., receive additional points.
>
> (MMC Report, Section I, p. 51)

[120] MMC found that some insurance companies have recently introduced new practices which restrict the ability of customers to obtain automobile insurance coverage on the same terms as they obtained it in the past. MMC's report stated that:

> Our review of the underwriting manuals of the surveyed companies indicate that some companies recently adopted what can be viewed as more restrictive underwriting practices. One example would be the removal of the accident forgiveness rule, previously used by an insurance company, and commonly used (various forms) by most companies.
>
> (MMC Report, Section I, p. 63)

[121] The Coalition Against No Fault Insurance stated that:

> Anecdotal evidence submitted to the Board by the informal participants suggest that there may be incidents where insurance companies are discriminating against drivers in Nova Scotia.
>
> The analysis conducted by MMC suggest that, industry wide, there appears to be a practice of discriminating against young male drivers and senior drivers through unjustified rate increases or unduly restrictive rating practices. (Post-Hearing Brief, p. 6)

[122] IBC acknowledged that there is limited evidence of more restrictive

underwriting practices with respect to seniors:

> Seniors/ Youth
>
> It is clear that the evidence does not confirm alleged discrimination against youthful drivers. With respect to seniors, although there was an indication by a few companies of more restricted underwriting practice, that only applied to new applications for new insurance. There is not a basis to come to a conclusion that rates are discriminatory in either category.
> (IBC Rebuttal Brief, p. 4)

[123] IBC also acknowledged that in a few cases companies may have tightened their underwriting guidelines with respect to new business.

> Q. And there is some indication in the MMC materials that restrictive underwriting practices, while it may not be affecting premiums, may be affecting the ability of seniors to obtain insurance.
>
> A. (Forgeron) I'd like to respond to that Mr. Chair, we've reviewed rate manuals which are filed with the Board with a view to looking at this question, and I think on balance the industry has not discriminated against seniors. Many insurers in Nova Scotia continue to provide discounts for seniors well into their 70's, clearly indicating that there is not an age bias there with respect to a more preferred rate. It's true that some companies have tightened their underwriting guidelines, especially for new business. In most cases, this applies to all classes of business, not just seniors, but I believe there will be a couple of cases where you will see that they are directed at seniors. So in isolated cases there are some restrictive underwriting practices, but on balance in general the industry is treating seniors the way that it's treating the rest of the general driving population. (Transcript, pp. 190-191)

[124] IBC indicated that the implementation of restrictive practices by insurance companies is a sign of a "*hard*" insurance market:

> IBC acknowledges that a hard insurance market brings with it a tougher climate for consumers. Underwriting becomes more restrictive, premiums increase and, in some cases, the percentage of drivers in Facility Association increases. We have seen all these occur in Nova Scotia during 2002. However, these three issues are all symptoms of the larger problem of increasing pain and suffering awards for soft tissue injuries and corresponding financial losses by insurers. Restricting underwriting practices will not solve the larger problem and could in fact make the situation worse by increasing financial losses to insurers.
> (IBC Post-Hearing Brief p. 25)

4.10.1 Board Findings - Restrictive Underwriting Practices

[125] The Board finds that there appears to be some evidence of restrictive underwriting practices being implemented by some insurance companies. The nature and extent of these practices are difficult to quantify based on the evidence before the Board. A more comprehensive review would be required to determine the extent to which such practices are being adopted by the various companies.

5.0 Rate Shock and Future Actions

[126] The closing brief from the CBA stated that:

> It is reasonable to conclude that the current round of unprecedented premium increases that have been, and will be, imposed on Nova Scotia consumers could have been avoided with a more responsible and considerate approach to gradual premium adjustment at periodic intervals. (Closing Brief, p. 2)

[127] In its closing brief, IBC stated that:

> Principles of regulation concerning gradualism apply in circumstances where the regulator gives pre-approval of rates. The Board can and has (for example in circumstances involving Nova Scotia Power) phased in a rate increase in recognition of customer impact even though the rate applied for is reasonable based on accepted ratemaking principles. **That however is not the regulatory regime in Nova Scotia with respect to Insurance.** Here we have rates that are put in place by insurers without Board approval and the task of the Board is to determine whether these rates comply with or violate Section 157(2) of the *Insurance Act*. Therefore, unless the Board can conclude that rates offend Section 157(2), there can be no adjustment. It does not, we respectfully suggest, lie with the Board to adjust inadequate or reasonable rates. If on the evidence of MMC and Mr. Miller, rates are accepted as inadequate and reasonable, there is no opportunity to apply principles of rate shock to phase in increases. Such, it is respectfully submitted, is beyond the jurisdiction of the Board under Section 157 unless the Board makes an original finding that the rates violate Section 157. (Closing Brief, par. 93)

[128] The IBC thus suggests that the Board has no authority under the **Act** to order that rate increases be phased in, and that the issue of whether or not there is rate shock is irrelevant under **s. 157** of the **Insurance Act**.

[129] The Board does not disagree with this interpretation. However, it is clear to the Board that the rate increases imposed on consumers have been extremely harsh, and appear to have been imposed without consideration of the consumers' ability to pay. If there ever was a case of "rate shock", surely this is it. While the Board may have no jurisdiction to deal with "rate shock", the Board has serious concerns about the methods adopted by the insurance industry as it seeks to "make up for lost ground".

[130] While **s. 157** of the **Act** gives the Board authority to adjust rates if the Board finds them to be ". . . excessive, inadequate, unfairly discriminatory or otherwise unreasonable", in order to be able to do that the Board is of the view that it first has to provide each of the alleged offending insurance companies with an opportunity to respond. The Board cannot order a general roll-back of rates, because each company has a different rate and cost structure which has to be separately reviewed. In considering the process which it should follow in conducting the review requested by the Minister, the Board concluded that it was important to first obtain an overall view of automobile insurance rates in Nova Scotia. Essentially, this was the assignment which the Board commissioned MMC to undertake. This was the first step - to obtain the opinion of an objective consulting actuarial firm with respect to the overall increases in automobile insurance premiums in Nova Scotia. MMC's conclusions have been set out above. It found that the increases were reasonable for the industry as a whole, given the significant cost increases and resulting losses being faced by the industry.

[131] There is evidence that a number of insurance companies are now earning a reasonable rate of return on equity, while others are still incurring losses, or are earning

very low rates of return.

[132] The Board is satisfied that it has the authority under the **Act** to review increases in rates charged by individual companies where it has reason to believe that those companies may be earning excessive profits on their underwriting of automobile insurance in Nova Scotia. However, in view of the current review being conducted by the provincial government, the Board does not consider it appropriate to undertake such an investigation on its own initiative at this time.

[133] As stated above, the Board is concerned about the manner in which the insurance industry has chosen to implement these significant increases in insurance premiums. The nature of the Board's existing mandate pursuant to **Section 157** of the **Act** is such that any review conducted by the Board has to be carried out "after the fact". It is the Board's view that, after reviewing the evidence, Government would be well justified in considering the desirability of alternative regulatory models or making other structural changes in the automobile insurance system in Nova Scotia which would ensure that drastic and sudden rate hikes of the sort recently experienced by Nova Scotians could not be visited upon them again.

6.0 Possible Changes in Rate Regulation System in Nova Scotia

[134] Since 1958 Nova Scotia has had a "file and use" form of automobile insurance rate regulation. Rates automatically go into force 10 days after they are filed with the Board. The Board may, however, examine the rates after the fact and, following a hearing, may order an adjustment if it finds the rates to be excessive, inadequate, unfairly

discriminatory or otherwise unreasonable.

[135] The topic of rate regulation was not extensively canvassed at the hearing and the Board does not consider it appropriate to offer specific recommendations having regard to the terms of reference of this proceeding. However, the Board notes that several non-industry participants recommended that consideration be given by Government to establishing a "prior approval" form of rate regulation in Nova Scotia. At least one participant suggested that the Newfoundland system of rate regulation might be adopted in Nova Scotia.

[136] The Newfoundland and Labrador Board of Commissioners of Public Utilities uses a benchmark system to regulate automobile insurance rates. Based on the advice of its actuaries, the Newfoundland Board sets a benchmark range for rates each year. It is currently using MMC as its actuarial advisor, the same firm retained by this Board to assist it in the present review. Insurance companies may file rates above or below the range, but in that case they must individually justify their proposed changes. The justification process may involve a hearing. Proposed rates which fall within the range are not subject to review by the Newfoundland Board. It is this Board's perception that the principal benefit of such a system is that it tends to keep rates more closely aligned with increases in claim costs. The result is that rate shock may be reduced as rate increases would tend to be more gradual than is frequently the case in markets where there is no pre-approval of rates. The very fact that insurance rates are subject to prior review by a regulatory board may tend to make them more acceptable to consumers.

[137] The present legislative scheme in Nova Scotia typifies the free enterprise

model. Insurance companies are not required to justify their rates on an actuarial basis in advance of implementing them. The rates they charge may reflect market rather than pure ratemaking considerations. The result is there is likely to be a broad range of rates available to customers given the differing profit goals and market share objectives of the various companies. On the other hand, under a benchmark prior approval system, the companies are likely to have somewhat less flexibility to price "low" or "high". That the spread of rates from one company to another will likely be narrower under a prior approval benchmark system may be attractive to some consumers.

[138] Persuasive arguments can be made against the adoption of a prior approval form of rate regulation. Insurance companies lose a degree of flexibility in adjusting rates to meet new conditions. From the consumer's perspective, just as rates may increase more gradually under a pre-approval system, they may decline more slowly as well. Admittedly, past experience suggests that rates are far more likely to increase than decrease in the automobile insurance industry.

[139] Mr. Forgeron expressed the view that the regulatory process in Newfoundland is "very cumbersome and expensive" and increased regulatory costs will ultimately be borne by consumers. He also testified that, based on consumer surveys, it appears that consumers in Newfoundland are every bit as upset with high automobile insurance rates as they are in Nova Scotia. He made the following point in response to a question as to why recent loss ratios have been lower in Newfoundland than in Nova Scotia:

> Part of the problem in Newfoundland has been that while rates have been moving upward perhaps more steadily and gradually than here in Nova Scotia, the underlying problems in the system are the same there as they are here, and they have yet to be addressed. And by simply raising rates, whether its through a regulatory, a strict regulatory environment or through market forces, again we arrive at the same point . . . in spite of the much higher premiums in Newfoundland, loss ratios continue to be unacceptable and rates continue to go up. So, regulated or not, it's the underlying problems in the system that dictate what those levels are, whether it's through a regulated entity doing the rate-making or the market.
> (Transcript, pp. 474-475)

[140] While it is not particularly meaningful as a comparison, given that claims experience in the two provinces differs, it is worth noting for the record that the average premium in Newfoundland in 2001 was $753 compared to $674 in Nova Scotia according to IBC.

[141] Mr. Miller made the interesting assertion that, at the end of the day, if rates began to increase sooner in Newfoundland, then consumers in that province have ended up paying relatively more than have Nova Scotia consumers. Rates are set on a prospective basis and insurance companies in Nova Scotia cannot now go back and recoup their past losses.

[142] Finally, the point is often made that rate regulation works best where the company being regulated is a monopoly. Nova Scotia Power Inc. is an example. The trend in recent years in Canada has been to deregulate those industries which have become more competitive. Long distance and cellular telephone services come to mind. Whether or not the automobile insurance business is as competitive as it could be, it has to be said that it is a very long way from being a monopoly.

7.0 Board Conclusions

[143] As the evidence submitted during this hearing indicates, for insurance companies writing private passenger automobile insurance business in Nova Scotia, their financial results in recent years have been nothing short of abysmal. Their earnings from this line of business have not been adequate by any reasonable standard. As can be seen from Table III at paragraph 92, the industry incurred total losses of $224 million during the accident years 1997 to 2001.

[144] Given these large losses, it is not surprising that the automobile insurers have been taking drastic action to restore profitability.

[145] Based on the evidence submitted at the hearing, the Board is of the view that, as at August 2002, the date of the MMC report, the overall level of private passenger automobile insurance rates was not excessive, inadequate, unfairly discriminatory, or otherwise unreasonable.

[146] In the Board's view, the major reason for the losses experienced by the industry is the increasing cost of claims. In this regard, the Board finds that the evidence is compelling that the primary cause of the increased claim costs is claims for compensation for bodily injuries.

[147] The evidence shows that third party liability claim costs have been increasing much faster than collision and comprehensive claim costs. The increase in the average cost of a bodily injury claim over the last five years has been dramatic.

[148] MMC has concluded that, assuming an after-tax return on equity of 10% for private passenger automobile insurance, premiums should have been 47% higher in 2001

than those which were charged. MMC noted that if a ROE of 7.5% were assumed, the earned premium inadequacy would have been about 43%, and at an assumed ROE of 5%, the earned premium inadequacy would have been about 38%. MMC further stated that even after the increases which had occurred to the date of their report, current average premiums for the year 2002 were approximately 10% to 20% below the level necessary to achieve an after-tax ROE of 10%. MMC has indicated that the evidence shows that future increases will be concentrated in the third party liability coverage.

[149] MMC has also indicated that, barring unforeseen changes, claim costs being incurred by insurance companies will continue to increase at approximately 7% a year. The Board concludes, for the reasons set out in the report, that continuing cost increases are to be expected as long as the existing automobile insurance system in Nova Scotia remains as it is today.

[150] It is clear to the Board that the rate increases imposed by the insurance companies on consumers have been extremely harsh, and appear to have been imposed without consideration of consumers' ability to pay. If there ever was a case of "rate shock", surely this is it. While the Board may have no jurisdiction to deal with "rate shock", the Board has serious concerns about the methods adopted by the insurance industry as it seeks to "make up for lost ground".

[151] The Board heard evidence, that while individual insurance companies were aware of the significant losses they were experiencing, they did not immediately act to increase rates in the expectation that conditions would improve. Unfortunately, this did not occur and the insurance companies had to implement sharper rate increases as a "catch

up" measure. The Board finds that if insurance companies had taken action earlier than they did, a more gradual rate increase could have been implemented to achieve similar results.

[152] The Board's concerns outlined above are heightened as a result of the apparent continuing increases which have been implemented since the conclusion of the hearing. The nature of the Board's existing mandate pursuant to **s. 157** of the **Act** is such that any review conducted by the Board has to be carried out "after the fact". It is the Board's view, after reviewing the evidence, that Government would be well justified in considering the desirability of alternative regulatory models or making other structural changes in the automobile insurance system in Nova Scotia which would ensure that drastic and sudden rate hikes of the sort recently experienced by Nova Scotians could not be visited upon them again.

[153] The Board finds that there appears to be evidence of restrictive underwriting practices being implemented by some insurance companies. The nature and extent of these practices is difficult to quantify based on the evidence before the Board. A more comprehensive review would be required to determine the extent to which such practices are being adopted by the various companies.

[154] With respect to whether the rates are *unfairly* discriminatory, there is no question that rates are discriminatory based on a whole host of factors, such as age, location, etc. The Board has heard evidence that there may be unfair discrimination concerning rates for youths and seniors, but without further study and information it is not possible to reach any definitive conclusion in this regard.

DATED at Halifax, Nova Scotia, this 13th day of May, 2003.

John A. Morash, Chair

John L. Harris, Member

Kulvinder S. Dhillon, Member

APPENDIX A

On behalf of:	Witness:
The Insurance Bureau of Canada	Donald W. J. Forgeron Ronald R. Miller Les Kishi
CGU Insurance Company of Canada	Karl H. Driedger Ron Dauphinee
Co-operators General Insurance Company	Andrew Cartmell Terry McRorie Sherry Folkerson Brian Gaudette
Economical Insurance Group	Gordon Murray Robert Gibson Irving Fancy Louis Durocher
Nova Scotia Coalition Against No Fault Insurance Nova Scotia Provincial Injured Workers Association Nova Scotia Designer Crafts Council	 Gordon Adair
Nova Scotia Senior Citizens' Secretariat	Rex Guy
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Informal Participants	Mary Hamblyn - Nova Scotia Advisory Council on the Status of Women Wendy Lill - Member of Parliament for Dartmouth June King Michael Chase Byrne Williams George Campbell Father Frank Ralph John Henry Paw Gregor Sperry Frank Corbett, NDP Caucus Office Rubin A. Coward Danny Graham, Leader, Liberal Party Darren MacKay Irene Wheatley